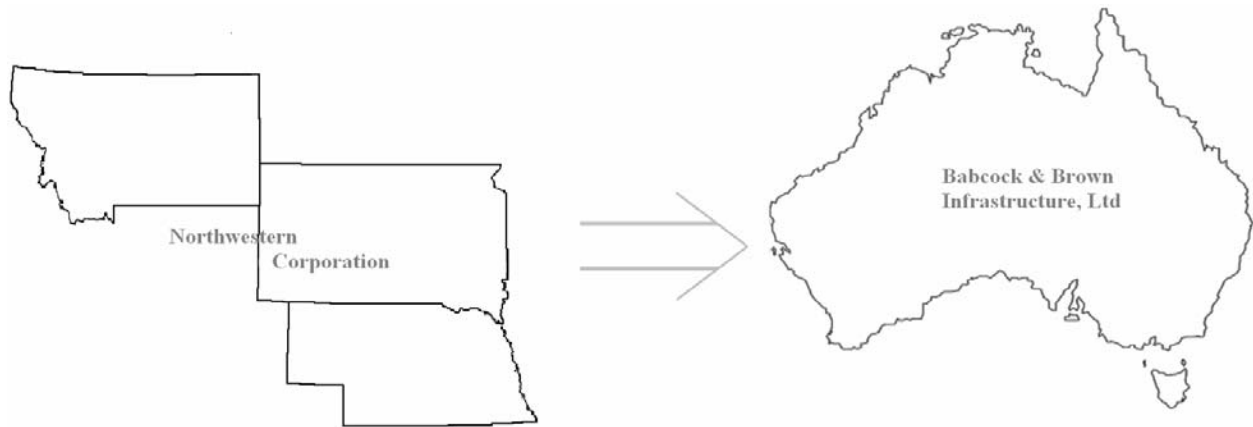


FACT SHEET

Docket D2006.6.82

**Joint application for acquisition of
NorthWestern Corporation
by
Babcock & Brown Infrastructure, Ltd**



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Fact Sheet

INTRODUCTION AND PROCEDURAL BACKGROUND

On June 7, 2006, NorthWestern Corporation d/b/a NorthWestern Energy (NorthWestern or NWE) and Babcock & Brown Infrastructure, Ltd. (BBIL), BBI US Holdings Pty. Ltd., BBI US Holdings II Corp., and BBI Glacier Corp. filed a joint application with the Montana Public Service Commission (PSC or Commission) asking that the PSC authorize BBIL's acquisition of NorthWestern under an Agreement and Plan of Merger.

A *Notice of Application and Intervention Deadline* was issued by the Commission on June 23, 2006. The Commission subsequently granted intervention to: Montana Consumer Counsel (MCC); AARP Montana (AARP); Colstrip Energy Limited Partnership and Yellowstone Energy Limited Partnership (CELP/YELP); Human Resource Council District XI/Natural Resources Defense Council/Renewable Northwest Project (District XI/NRDC/RNP); International Brotherhood of Electrical Workers Local #44 (IBEW Local #44); Montana Large Customer Group (LCG); and Heartland Consumers Power District and South Dakota Public Power Inc. (Heartland/SDPPI).

On July 20, 2006, the Commission issued a procedural order establishing a schedule for consideration of the application and setting a tentative public hearing date of March 14, 2007, depending on whether any additional issues were identified by PSC staff after receipt of intervenor prefiled testimony. The deadlines in the procedural schedule were suspended by *Notice of Staff Action* issued September 12, 2006, due to pending protective order issues. The procedural schedule was reinstated and amended by *Notice of Staff Action Amending Procedural Schedule* issued October 31, 2006, with the tentative hearing date still scheduled for March 14, 2007. No additional issues were identified by staff.

On February 22, 2007, the Commission issued its *Notice of Public Hearing* for the March 14, 2007 hearing. In addition, 15 public meetings have been or will be held by commissioners between February 8 and March 12, 2007, to obtain public comments on the sale proposal in the following towns in NorthWestern Energy's service area: Glasgow, Havre, Lewistown, Great Falls, Hamilton, Missoula, Billings, Bozeman, Butte, Kalispell, Choteau, Conrad, Browning, Cut Bank, and Helena.

NORTHWESTERN CORP.'S AND BBIL'S JOINT APPLICATION

The application provided overviews of NorthWestern (pp. 5-7) and BBIL (pp. 8-10) and asserted that, after NorthWestern conducted an evaluation of its strategic alternatives and considered final bid proposals, the NorthWestern board of directors determined that a sale of the company to BBIL in accordance with the terms of the merger agreement was the best means of maximizing stockholder value and preserving NorthWestern's ability to provide utility service to its customers.

According to the application, although the form of the transaction is a merger, the transaction is actually a transfer from NorthWestern to BBIL of 100 percent of NorthWestern's common stock. The proposed transaction will take the form of a merger of BBI Glacier Corp. (Glacier) with and into NorthWestern with NorthWestern surviving the merger as a wholly owned indirect subsidiary of BBIL. Generally, owners of NorthWestern common stock will receive \$37 per share of stock owned on the effective date of the merger. BBIL will assume NorthWestern's existing debt. NorthWestern will no longer be listed on NASDAQ but NorthWestern will still have publicly traded debt that requires the filing of financial disclosure reports with the U.S. Securities and Exchange Commission (SEC). According to the application, the only changes to NorthWestern will be the identity of its stockholders and ownership under a holding company structure.

The applicants stated the application was filed in accordance with the terms of the July 2004 *Stipulation and Settlement Agreement* among NorthWestern, the Montana Consumer Counsel (MCC) and the Commission associated with NorthWestern's emergence from bankruptcy, as well as the terms of the PSC's *Consent Order* in Docket D2003.8.109.

The applicants requested the Commission find that NorthWestern has complied with the Consent Order provisions and consent to BBIL's acquisition of NorthWestern under the merger agreement, or, in the alternative, determine after hearing in a contested case proceeding that NorthWestern has complied with the terms of the Consent Order, consent to BBIL's acquisition of NorthWestern under the merger agreement, and modify the Consent Order as necessary to implement the merger agreement.

A copy of the merger agreement between NorthWestern and BBIL is included with the application as Appendix 1. The proposed agreement calls for BBIL, through the merger of Glacier into and with NorthWestern, to acquire 100 percent of the outstanding shares of

NorthWestern, subject to regulatory and NorthWestern shareholder approvals, for \$37.00 per share in an all cash transaction, which values NorthWestern at approximately \$2.2 billion. BBIL will pay approximately \$1.5 billion, including closing costs and \$736 million of existing NWE debt will remain in place.

APPLICANTS' PREFILED DIRECT TESTIMONY (Appendix 4 of the Joint Application)

Prefiled direct testimony of Michael J. Hanson (NorthWestern)

According to Mr. Hanson, the key objective of the proposed transaction is for NWE to continue to provide adequate service at stable, reasonable rates without the distraction and uncertainty of investors with short-term monetary goals. Mr. Hanson added that BBIL's capital resources will allow NorthWestern to pursue infrastructure development and other growth opportunities in Montana such as generation and transmission.

Mr. Hanson described NWE and its utility operations in South Dakota, Nebraska and Montana. NWE's regulated electric utility operations in Montana consist of over 7,000 miles of transmission lines and 20,300 miles of overhead and underground distribution lines to approximately 316,000 customers in 187 communities. NWE also serves as the default electricity supplier for 310,000 residential and commercial customers. On the natural gas side, NWE purchases, stores, transports and distributes natural gas to Montana customers. NWE's regulated natural gas system in the state consists of a distribution system of approximately 3,700 miles of underground pipelines and a transmission system of more than 2000 miles of pipelines. NWE is the default supplier for its natural gas customers in Montana.

Mr. Hanson said that, since emerging from bankruptcy in November 2004, NorthWestern has accomplished much to increase its financial stability, as evidenced by quarterly increases in net income, paying debt down to below a 50 percent debt/equity ratio, strong operating cash flows and liquidity, reduced interest expense, improved credit ratings on debt, the disposition of the large majority of its non-utility assets and the resolution of many lawsuits.

According to Mr. Hanson, although NorthWestern's corporate headquarters is located in Sioux Falls, South Dakota, the majority of NWE's activities and key utility operational management operate out of Montana. He cited as examples the location in Butte of most of NWE's primary administrative support personnel functions, the System Operations and Control

Center, the majority of its energy supply, transmission and distribution operations personnel, and regulatory and government affairs personnel and functions. Mr. Hanson noted that two of the five members of NWE's Energy Supply Board are located in Montana.

Mr. Hanson pointed to energy supply as the greatest challenge facing NWE and claimed BBIL understands the situation and supports NWE's efforts to address it. Mr. Hanson said that, with BBIL's support, NWE is in a position to explore all options including the possibility of equity ownership in rate-based generation.

Mr. Hanson provided background and information about NorthWestern's strategic review process that resulted in the proposed transaction with BBIL. He said NorthWestern's board of directors ordered a thorough review of the strategic alternatives, including continuing as a stand-alone company, a financial restructuring, various merger scenarios, and sale of the company. After analyzing the alternatives and final proposals, the board determined that a sale was the best means of maximizing stockholder value and preserving NWE's ability to provide adequate service at reasonable rates. Mr. Hanson stated that all bidders for the company were advised to focus on the terms of the bankruptcy settlement agreement, the Consent Order by which the Commission approved the settlement agreement, and the provisions of the Commission's October 2004 *Statement of Factors For Evaluating Proposals To Acquire NorthWestern Energy*. Mr. Hanson said the NorthWestern board decided BBIL's offer provided the best value for all of its customers, employees, regulators and stockholders. Mr. Hanson asserted BBIL will be a long-term owner that is experienced in core utility assets and infrastructure, which is preferable to an owner focused on short term returns, particularly if new investment is required.

Mr. Hanson described the proposed transaction as a merger of BBI Glacier Corp., a wholly owned indirect subsidiary of BBIL, with and into NorthWestern with NorthWestern surviving the merger as a wholly owned indirect subsidiary of BBIL and BBI Glacier Corp. ceasing to exist. Details regarding the effect of the merger on NorthWestern's shareholders are provided on pages 12-14 of Mr. Hanson's testimony.

Under current ownership or the ownership of BBIL, Mr. Hanson stated that NWE will comply with the terms of the bankruptcy settlement agreement and Consent Order.

Prefiled direct testimony of Michael M. Garland (BBIL)

Mr. Garland is the president and member of the board of directors of BBI US Holdings II Corp. (Holdings II) and BBI Glacier Corp. He explained that BBIL, together with Babcock & Brown Infrastructure Trust (BBIT), form BBI. BBI is a utility infrastructure company based in Sydney, Australia, that is listed on the Australian Stock Exchange and has a current enterprise value of approximately \$4.9 billion. BBI owns companies in electricity transmission and distribution, gas transmission and distribution, transport infrastructure, and has ownership interest in thermal and renewable power generation. According to Mr. Garland, BBI's energy sector is managed by utility executives with an average of over 25 years experience in the electric and gas transmission and distribution businesses. Mr. Garland said that each operating BBI company is managed locally.

Mr. Garland explained that the proposed post-merger structure will involve two BBIL-subsidary holding companies. He said companies such as BBI that operate in multiple jurisdictions often form two holding companies to segregate investments, limit the reach of unforeseen liabilities and enable efficient tax structuring. This structure, according to Mr. Garland, enables expansion of the local entity independent of other parent operations and investments and allows BBI to ring-fence each business, sheltering each from the risks and obligations related to other BBI businesses. Following the proposed BBIL/NorthWestern merger, the following BBIL companies would constitute the organizational structure:

- BBI US Holdings Pty Ltd. (Holdings Pty) - a wholly-owned Australian direct subsidiary of BBIL that was formed to hold the equity interests of Holdings II.
- BBI US Holdings II Corp. (Holdings II) - a Delaware corporation, a wholly-owned subsidiary of Holdings Pty formed to hold the equity interests in Glacier and, following completion of the acquisition, NorthWestern.
- BBI Glacier Corp. (Glacier) - a Delaware corporation, a wholly-owned indirect subsidiary of BBIL, a special purpose company formed to merge with and into NorthWestern. Glacier is a direct subsidiary of Holdings II, which is in turn a wholly-owned subsidiary of Holdings Pty.

Mr. Garland asserted BBI's commitment to meet the ring-fencing expectations of the Commission and said BBI will not pledge its interest in NorthWestern to secure financing of other ventures.

Mr. Garland described BBI as an experienced utility infrastructure owner with a conservative approach that owns and operate its assets on a long-term and financially stable basis. He said BBI's interest in NorthWestern stems from the quality of NWE's assets, its stable existing customer base and its steady growth opportunities, as well as its similarity to BBI-owned Powerco, a New Zealand electric and gas transmission and distribution company.

According to Mr. Garland, the total amount of funds necessary to complete the merger is \$2.228 billion, of which \$736 million represents existing NorthWestern debt and the remaining approximately \$1.492 billion will be funded through a combination of equity contributions by BBIL and debt financing. He explained that approximately \$987 million is expected to be provided by BBI from existing cash and from equity issuances in capital markets. BBI's market capitalization is about \$1.7 billion, he said. Mr. Garland noted that Moody's Investor Services has informed BBI that, if the transaction is completed and the financial and operating projections are realized, BBI's post-merger investment grade rating (Baa3 stable) will likely be retained.

As for the required debt financing, Mr. Garland said BBI has obtained commitments in the amount of \$505 million for an acquisition bridge financing facility to be provided to Holdings II that is non-recourse to NorthWestern. According to Mr. Garland, the loan will be repaid out of dividends paid by NorthWestern to Holdings II, and it will not be secured in any way by NorthWestern or its assets.

Mr. Garland said BBIL assumes little or no refinancing of existing NorthWestern corporate debt will be required to consummate the merger. He noted that NorthWestern's \$225 million worth of Senior Secured Bonds has a change of control feature that would be triggered if the bonds are not investment grade as rated by Standard & Poor's and Moody's when the change of control occurs. However, BBIL believes NorthWestern will achieve an investment-grade rating because of those rating agencies' positive announcements in April 2006 regarding NorthWestern's credit rating. Regarding the revolver facility, which also has a change of control trigger, Mr. Garland said BBIL and NorthWestern will work with the lenders to maintain the existing facility.

According to Mr. Garland, each of BBI's companies makes appropriate capital expenditures related to maintenance, replacement, enhancement of existing infrastructure or growth opportunities. He said BBI is able to access capital markets to supplement NWE's cash flow when necessary. He provided a list (on pages 10-11 of his testimony) of various BBI

companies' capital expenditure commitments for fiscal year 2006. NWE local management will bring to the NorthWestern board for approval investment proposals requiring discretionary and growth capital expenditures.

Mr. Garland said BBI considered the bankruptcy settlement agreement and PSC Consent Order when it made its bid for NorthWestern and that the transaction will substantially comply with them. He said that, although the agreement and order refer to a parent company and NorthWestern will be a wholly-owned BBIL subsidiary under the structure of the proposed transaction, NorthWestern will still operate as a utility company similarly to what it now does as a parent company. In addition, he said, BBI ring-fences each of its assets and would do the same with NorthWestern.

Mr. Garland asserted BBI satisfies a preponderance of the elements and set forth in the Commission's Statement of Factors as follows:

- Financial strength and capability. Mr. Garland claimed that BBI is an investment grade infrastructure owner and a long-term investor in businesses that provide stable, consistent cash flow. According to Mr. Garland, BBI does not intend to recover any acquisition premium it is paying for NorthWestern from ratepayers; BBI will maintain the ring-fencing protections of the settlement agreement and consent order; BBI will maintain existing employee levels for two years and benefit plans for at least two years, and subject to certain conditions, three years; and BBI will maintain the current funding commitment to NorthWestern's pension plan.
- Energy supply. According to Mr. Garland, BBI's energy sector managers average 25+ years experience in electricity generation and electric and gas distribution. He said BBI will work with NWE to acquire appropriate and balanced supply under the PSC's guidelines and complete the electric default supply portfolio.
- Infrastructure. Mr. Garland said BBI will work with NWE to fully implement the Liberty Consulting infrastructure audit recommendations.
- Demonstrable Montana focus. Mr. Garland said BBI will retain local management and staff in Montana; focus on local jobs and investment in Montana; continue NorthWestern's current customer and community programs, existing energy assistance and charitable giving programs; and meet conservation and renewable energy commitments.

- Utility focus. According to Mr. Garland, BBI agrees with NWE's approach to maintain focus on distributing gas and electricity to its customers in a regulated environment.
- Customer focus. Mr. Garland said NWE's commitment to meeting the PSC's customer service expectations will not change.
- Energy utility management experience. Mr. Garland said BBI is an experienced owner/operator of regulated energy utilities and reiterated the related experience of BBI's senior energy sector management. He asserted that BBI's experience will provide NWE additional resources to better serve Montana customers. Mr. Garland listed and described BBI's energy sector assets (Powerco in New Zealand, IEG in the United Kingdom and elsewhere, Cross Sound Cable in New York, 50 percent of Ecogen Power in Australia, and 50 percent of Redbank Power Station in Australia).
- Effective functioning in the Montana constitutional, statutory, and regulatory framework. Mr. Garland reiterated BBI's experience operating in regulated environments.

According to Mr. Garland, there will be very little, if any, difference in NorthWestern's daily operations if the transaction is approved. BBIL will keep NorthWestern's current management in place and supports NorthWestern's current business plan. In addition, he said, BBIL intends to create long-term value by continual investment in NWE's infrastructure. Mr. Garland testified that BBI will assist NorthWestern in continuing to improve its financial strength and access to financial markets and will provide NorthWestern with enhanced access to capital to fund organic growth as appropriate to ensure stable ratings and reduce long-term debt costs. He said BBI's resources and experience could be helpful as NWE works to improve the energy supply situation in Montana.

INTERVENOR PREFILED TESTIMONY

Response testimony of John W. Wilson (MCC)

Dr. Wilson, testifying on behalf of MCC, concluded that the proposed acquisition will adversely affect NWE's ability to provide adequate service at reasonable rates and that, as proposed, it would provide few benefits to Montana customers. He recommended that, if the

PSC authorizes the acquisition of NorthWestern by BBI, certain minimum conditions should apply.

Dr. Wilson noted that, although Mr. Hanson touted BBIL's financial resources, BBIL's market capitalization of \$1.7 billion makes it only a bit financially larger than NorthWestern and there is no evidence that BBIL's parent Babcock & Brown will contribute to NorthWestern's ability to provide utility service. With respect to capital expenditures, Dr. Wilson observed that BBI's acquisition model only provides for a 2 percent annual increment and that, according to the model, BBI will not retain earnings for capital expansion or contingencies, but rather will consider and finance those requirements as they arise.

Dr. Wilson claimed that BBI plans to support its proposed \$2.2. billion acquisition of NorthWestern, which has a \$1.4 billion rate base, by substantially increasing NWE's equity distributions. According to Dr. Wilson, NWE's 2006 Long Range Forecast projected equity payouts to stockholders totaling \$203 million for the period 2007-2010 in contrast to BBI's plans to increase NorthWestern's equity payouts to its investors to \$660 million over the same period. Dr. Wilson asserted that BBI plans that NorthWestern will employ four "unusual" practices in order to fund the increased equity distributions: (1) retention of the acquisition premium of \$700 million in its utility capital structure to justify utility borrowing of \$180 million for equity distributions and return on equity amounts; (2) use of \$300 million worth of depreciation over the next 15 years to fund equity payouts rather than new capital expenditures; (3) a BBI-projected increase in rate of return on NWE's equity-funded rate base to 30 percent by 2023, leveling off between 25 percent and 30 percent through 2046; and, (4) over-recovery in NWE's rates of more than \$200 million of tax expenses.

Dr. Wilson based most of his conclusions about BBI's plans for NorthWestern on his analysis of the results of BBI's acquisition model, a tool that Dr. Wilson said was used by BBI to evaluate the acquisition of NorthWestern and to arrange financing for it. Dr. Wilson asserted the acquisition model provides the best indication of BBI's expectations and intentions as the prospective owner of NorthWestern. He categorized the conclusions he reached from his review of the model into two groups as described below.

First, Dr. Wilson reached conclusions related to the model's projection that NorthWestern's debt will increase from \$736 million at the end of 2006 to \$1.854 billion by the end of 2009 because of large NorthWestern capital expenditures and corporate borrowings in the

2007-09 period, mostly for new transmission investments in the Montana-Idaho line and the 500-Kv Colstrip-NW upgrade. Besides assuming \$900 million in capital expenditures to fund the two transmission projects, Dr. Wilson claimed BBI's model also includes \$153.8 million to fund the planned Colstrip 4 lease buyout and \$90 million to fund what Dr. Wilson termed an unwarranted equity payout. Dr. Wilson said NorthWestern's equity, excluding acquisition adjustment goodwill, is projected to decline over the same period from \$732 million to \$531 million.

Second, Dr. Wilson reached conclusions related to what he asserted is BBI's business practice of paying out 100 percent of cash flow as management fees or dividends, which Dr. Wilson said is contrary to the customary U.S. utility practice of distributing an average of 60-70 percent of net earnings (a smaller subset of cash flow). According to Dr. Wilson, BBI expects cash flow from NorthWestern operations to be about 150 percent to 200 percent of net earnings. As a result, he argued, adequacy of NWE service is at risk because BBI will over-distribute NorthWestern earnings instead of funding and maintaining sufficient reserves.

A comparison by Dr. Wilson of the projected equity distributions in NWE's January 2006 Long Range Management Forecast for 2007-2010 with those in the BBI acquisition model for the same time period showed projected distribution amounts from NWE to BBI "holdco" that range from more than twice the NWE-projected distributions to more than four times the NWE-projected distributions. (See the table on page 14 of Dr. Wilson's testimony.)

According to Dr. Wilson, BBI's model shows BBI initially funds the projected equity payouts by including in rates tax expenses that exceed actual tax payments ("phantom taxes") and later by high and unrealistic earnings projections. In addition, Dr. Wilson claimed BBI's forecasts keep the \$700 million acquisition premium in the utility's capital structure. He argued the inclusion explains in part how BBI will support its \$2.2 billion capitalization while increasing NWE's forecasted equity distribution, when NWE has only \$1.4 billion worth of net plant and equipment. He added that the improper inclusion results in unwarranted NWE debt-funded equity distributions in 2008 and 2010 (\$90 million in borrowing each of those years) by which BBI "holdco" repays a portion of the debt it plans to issue in 2007 to finance the acquisition premium. Dr. Wilson disputed what he said was BBI's justification for the extraordinary equity distributions as being needed to achieve a 50/50 debt/equity capital structure

by arguing that, if the acquisition premium is excluded from NWE' capital structure, equity declines to a level less than 5 percent due to the very high equity payouts.

Dr. Wilson expressed concern that the \$900 million of new debt BBI's acquisition model assumes will be invested in the two transmission projects could become a burden for Montana ratepayers. He said BBI's assumptions about transmission markets and revenues are overly optimistic and, if they do not pan out, ratepayers rather than investors could be at risk. He said regulatory safeguards should be in place to protect against asset depletion at the NWE level because BBI's forecasts for a sustained level of equity payouts that exceed 150 percent of after-tax earnings for the period 2007-2016 and that exceed 140 percent through 2023 are significantly out of line when compared to the NWE-forecasted payout of 63 percent of earnings and the 63 percent average forecast by Value Line for comparable electric utilities.

According to Dr. Wilson, NWE's debt is projected to increase from \$736 million in 2007 to \$1.854 billion in 2009 due to debt funding of the planned transmission projects, the planned Colstrip 4 lease buyout, and the \$90 million equity payout to BBI holdco to pay off part of BBI's debt for the original equity acquisition premium. He argued that BBI's planned debt financing will result in an unacceptable leveraged capital structure, which he said would violate the bankruptcy settlement agreement that required NWE's consolidated total book equity/consolidated total capitalization to never be less than 40 percent. Dr. Wilson claimed that at the NWE utility level, excluding acquisition premiums, leverage is worse. (See pages 20-25 of Dr. Wilson's testimony for details and tables related to the projected consolidated and NWE-level capital structures.)

Dr. Wilson said he requested from BBI a run of the BBI acquisition model excluding the inputs and assumptions related to the interstate transmission projects. The requested model run showed that, even without those projects, equity payouts by NWE still significantly exceed 100 percent of total earnings and long-run earnings projections remain excessive and unrealistic. (The charts that comprise Exhibit__(JW-1) depict projected NWE cash distributions to equity owners under several different assumptions.) Notably, according to Dr. Wilson, equity payouts over the next 15 years greatly exceed total earnings and are much greater than NWE's 2006 equity distribution forecast of under 65 percent as well as distributions projected for comparable utilities. Dr. Wilson claimed payouts of this size are unrealistic, unsustainable and would adversely affect NWE's ability to provide adequate service at reasonable rates.

According to Dr. Wilson, BBI plans to more than double NWE's current level of equity payouts through 2023 by paying out 100 percent of earnings each year, plus issuing "advances to shareholders" that average an additional 40 percent of earnings. Dr. Wilson disputed the accuracy of BBI's discovery responses to the PSC that implied there would be no change in NWE's current dividend policy.

Dr. Wilson said BBI intends for ratepayers to subsidize the acquisition premium paid by BBI to acquire NorthWestern. He claimed BBI will include the acquisition premium in the ratemaking equation in order to justify NWE utility level earnings by including the premium in the equity component of the utility's capital structure. He also argued that, contrary to BBI's claim that it must issue \$90 million in NWE opco-level debt in 2008 and in 2010 in order to maintain a 50/50 equity-to-debt ratio, that debt issuance would only be necessary if acquisition premiums are included in NWE's equity balance.

Dr. Wilson also asserted that BBI's model assumes NWE's post-merger plant investment and capital expenditures will be at levels considerably lower than and out of step with those of comparable utilities. He claimed BBI projects NWE capital expenditures about equal to equity payouts over time, while Value Line projects capital expenditures for comparable utilities at about 2.5 times equity payouts. Exhibit__ (JW-4) summarizes projected capital expenditures for comparable companies.

Additional concerns expressed by Dr. Wilson include: that BBI's model expects returns on equity that are unrealistic (see Exhibit__(JW-3)); that BBI's plan to fund the equity payout to BBI Holdco includes reflecting in rates more income tax expenses than are actually paid ("phantom taxes"); and that BBI's use of "phantom taxes" is questionable because it is unclear whether the underlying assumptions related to net operating loss carry forwards are consistent with information submitted by NWE in PSC Docket D2006.10.141 as well as BBI's failure to recognize there will likely be regulatory questions in a subsequent rate proceeding about the appropriateness of rates that include large increments for tax costs that have not actually been paid.

According to Dr. Wilson, the proposed acquisition does not satisfy the objectives of the bankruptcy settlement agreement and the related PSC Consent Order or the PSC's October 2004 Statement of Factors. He said the proposed acquisition will result in noncompliance with ¶ C.3.a of the Consent Order, which sets a 40 percent floor on the equity component of the consolidated

capital structure for NorthWestern and its affiliates. He noted this is one of the ring-fencing provisions that is meant to insulate the utility from the risks of non-utility ventures. Dr. Wilson added that overleveraged utilities generally incur higher debt costs, which could result in higher utility rates and/or service quality deterioration.

Dr. Wilson contended that BBI addressed the Statement of Factors rhetorically, not substantively.

Dr. Wilson recommended that, if the PSC approves the acquisition, the approval should be subject to the following conditions at a minimum:

- No recovery in retail rates, directly or indirectly, of any portion of the \$700 million acquisition premium unless it is expressly authorized by the PSC after demonstration by the company of benefits to Montana ratepayers.
- No deferral of any of the transaction and transition costs incurred by BBI and NorthWestern as a regulatory asset for future rate recovery. Costs must be borne exclusively by shareholders.
- No distribution in any year in excess of 100 percent of net earnings from utility operations from NorthWestern to its owners, affiliates, or affiliates' shareholders, either directly or indirectly, without prior PSC approval.
- Financing for any capital projects for purposes other than providing service to NWE's retail utility customers must be non-recourse to NorthWestern and its customers.
- Continuation of the structural and financial measures, intercorporate and affiliate transactions requirements, reporting and disclosure requirements, and infrastructure audit compliance requirements from the Consent Order, with these modifications:
 - Revise the definition of the term "Parent Company" as necessary throughout ¶ C.1 and ¶ C.2 to ensure NorthWestern controls the public utility assets.

- Amend ¶ C.3.a to reflect a meaningful post-acquisition basis for determining consolidated book equity and consolidated total capitalization and the financial reporting requirements to which the corporate structure will be subject.
- A requirement that NWE submit rate informational filings with the PSC every 2 years in accordance with ¶ B.1 of the Consent Order for 10 years after the merger.
- A requirement that financial disclosure documents filed by BBIL in the Australian Stock Exchange or the Australian Securities and Investments Commission be publicly filed at the same time with the PSC.

Dr. Wilson additionally recommended that any Commission approval make clear that: (1) funds for the new debt issuances must be raised through project financing that depends solely on project revenues with no recourse to ratepayers; (2) approval of the acquisition does not mean endorsement of BBI's projected equity payouts and, in fact, they seem excessive, outside industry norms, and unlikely to receive future regulatory approval; (3) NWE's rate of return on rate base will be computed based on a capital structure that excludes acquisition premiums or any type of "goodwill" that exceed net plant value and neither NWE or its owners will recover from ratepayers, directly or indirectly, any acquisition premiums; and (4) the Commission reaffirms the Consent Order's provisions that require that neither the consolidated capital structure nor NWE's capital structure fall below 40 percent and that sufficient earnings must be retained to meet potential capital investment needs and to support investment grade ratings at the operating company and consolidated levels.

Response testimony of Ann Gravatt (District XI/NRDC/RNP)

Ms. Gravatt applauded the development of the Judith Gap wind project, but indicated that the potential of renewable resources in Montana has yet to be realized. According to Ms. Gravatt BBI, or any new owner of NWE, must expand the development of Montana's robust renewable resources and address any issues that are impeding that development. She said it is possible that changes in law will be enacted that will allow NWE to own and rate base generation. This

would require the new owner to make critical and long-lasting decisions about the mix of energy resources and their associated environmental and economic impacts.

According to Ms. Gravatt, new ownership of NorthWestern will have to quickly come to grips with the reality that continued business-as-usual reliance on conventional fossil fuel generation is no longer a viable option for utilities now that the financial and environmental risks of global warming are front and center.

Ms. Gravatt said that with the completion of the Judith Gap wind project, Montana has about 145 MWs of wind power operating, as compared to over 800 MWs of wind in Washington and around 440 MWs in Oregon, both states with moderate wind resource compared to Montana. She said neighboring states have also recently developed wind power projects, such as Wyoming with just under 290 MW and North Dakota with about 125 MWs and more on the way. Ms. Gravatt is concerned that NWE will proceed haltingly towards additional wind or other renewable energy acquisitions. She argued Montana citizens should not have to wait to get the benefits of reduced risk, economic development, and clean air from its homegrown resources.

Ms. Gravatt said she expects the applicants, particularly given BBI's wind power experience, to grow NWE's investment in new renewables. At the very least, NWE must obviously meet the target created by SB 415, the state's Renewable Energy Standard, which means 15 percent of its load will be met with new renewables by 2015. Given that NWE already has about 7 percent with Judith Gap, she stated the additional increments of 10 percent by 2010 and 15 percent by 2015 are modest targets, allowing NWE plenty of time to gain operating experience with Judith Gap while starting to explore the addition of other renewables to its resource mix.

Ms. Gravatt acknowledged there are challenges associated with the deployment of wind energy on a large scale. She said that there have been the usual start-up issues associated with any new resource. The wind's variability at Judith Gap, particularly on an intra-hour basis has presented more of an issue than anticipated. She said some of the difficulties at the Judith Gap project had nothing to do with the wind. She claimed a lack of communication between NWE default supply, NWE transmission, and Invenergy, the project's owner and operator, at least in the initial months of the project, was clearly not helpful. It was not appropriate for NWE to take over a year after the project was approved by the PSC to get the meteorological towers up and transmitting data, according to Ms. Gravatt.

She said NWE and BBI should commit to study and ultimately solve any wind integration issues and to explore with others transmission opportunities to access additional renewable resources in Montana. She viewed as essential NWE's continued active involvement in the Northwest Wind Integration Action Plan, convened by the Northwest Power and Conservation Council and the Bonneville Power Administration in August 2006. This group has discussed cooperative strategies, such as area control error (ACE) sharing, standardized regulating resource products, and regional wind forecasting, that could help control areas manage the variability in their systems.

Ms. Gravatt said she is encouraged by BBI's experience with wind power resources. With BBI's guidance NWE should continue to study its system and the wind resources available to determine how to integrate additional wind and renewable resources. With further analysis, NWE will know what sort of additional products, if any – such as load following, regulating or additional transmission – are needed to acquire additional wind or other renewable resources. BBI's expertise could also be valuable in addressing transmission limitations both inside and outside of Montana.

Regarding demand side management (DSM) programs, Ms. Gravatt said NWE has acknowledged the need to expand them in order to give customers access to all cost-effective savings. She said the new owner of NWE must be fully committed to these efforts. According to Ms. Gravatt, NWE should aggressively acquire all cost-effective efficiency on its system and devote sufficient resources, including staff, to the task. Ms. Gravatt questioned whether the lost revenue recovery mechanism is the best possible method of removing the disincentive to utility investments in conservation and achieving fairness for the utility and ratepayer. She said NWE should perform an updated and expanded estimate of the amount of cost-effective demand side resource on the system. She also favors accelerating the acquisition of the resource.

Ms. Gravatt asserted that increasing energy costs have imposed significant burdens on Montana's low-income population. She said NWE and any new owner must be aware of the company's continuing obligation to assist low-income customers.

Ms. Gravatt stated that BBI appears to have taken no corporate position on global warming and coal plants. She said BBI has touted its experience with coal resources and its willingness to bring that experience to develop more coal resources in Montana. In suggesting the possibility of new coal plants in Montana, BBI made no mention of carbon and global

warming. Ms. Gravatt expects BBI to reconsider its position on coal development in light of the urgent challenge of global warming, and will oppose any plans by NWE to acquire additional conventional coal resources. She claimed that long-term utility commitments to conventional coal-fired generation are imprudent, given that federal legislation controlling carbon is inevitable and imminent in her opinion. She added that utilities understand that the landscape has changed, and noted that several CEOs of the nation's largest utilities now publicly advocate federal controls on carbon.

Response testimony of Thomas Power (District XI/NRDC/RNP)

Dr. Power's testimony focused exclusively on the need to locate full control of NWE's Montana operations in Montana and not in Sioux Falls, South Dakota. At page 1, line 22, of his testimony, Dr. Power lists 10 conclusions that the analysis in his testimony supports.

In conclusions 9 and 10, Dr. Power recommended that the Commission should condition its approval of the proposed BBI purchase of NorthWestern on either the movement of NorthWestern's corporate headquarters to Montana or the establishment of a truly independent, stand-alone, Montana company. This is a reasonable condition, Dr. Power said, and pointed out that NorthWestern and BBI have already entered into an agreement with the South Dakota Public Utilities Commission to keep the corporate offices in South Dakota for three years. He said the Montana PSC should insist that either the corporate offices move to Montana at the end of that time period or that a stand-alone Montana company be established now.

Dr. Power noted that in its October 2004 Statement of Factors, the Commission indicated the need for any NorthWestern buyer to have a demonstrable Montana focus. The Commission at that time indicated that the sale of the South Dakota and Nebraska operations would accomplish a Montana focus.

Dr. Power noted that the difference between working with NWE and with the Montana Power Company in an advisory capacity has been dramatic. In the MPC era all of the management functions, including the top leadership, were located centrally in Montana. With NWE's takeover of the non-generating assets of MPC, decision-making within the utility appears segmented and confused, according to Dr. Power. Dr. Power said NWE employees in Butte appear to have limited authority and seem to be regularly surprised by decisions made by officers in Sioux Falls. He claimed systematic decision-making has seemed to collapse into an erratic

stop-start process that paralyzed decision-making for a time and then produced “emergencies” where decisions had to be made very quickly. He said the long and erratic course of obtaining long-term resources to support default supply provides a good example. He recalled that the Montana First Megawatts facility was in the mix, out of the mix, mysteriously back in the mix again, and then, just as mysteriously, permanently disappeared from the mix altogether.

According to Dr. Power, the separation of corporate offices in Sioux Falls and operational offices in Butte have had a negative impact on NWE’s ability to make use of its advisory committees. He said the NWE executives making some of the key decisions were never present and, sometimes, even the Montana personnel were not present because they were back in Sioux Falls. He claimed there was regular conflict between some of the Sioux Falls representatives and the advisory committee because those in Sioux Falls did not understand the role of the committee, Montana regulation, or committee members’ past involvement with the utility. Dr. Power said the net result of the division of authority was that the advisory committees could not be effectively engaged in assisting NWE in its decision-making in a timely and productive manner.

Dr. Power asserted the range of issues that NWE has brought to advisory committees has narrowed considerably. The only partially-functioning committee currently operating focuses exclusively on some of the default supply issues, while in the past there had been advisory committees dealing with low-income, universal systems benefits (USB), natural gas supply strategies, rate design, qualifying facilities, distributed energy policy (net metering, transmission and distribution cost savings, etc.), and legislative proposals. NWE is making decisions on these important issues without the assistance of any advisory committee involvement, according to Dr. Power.

Dr. Power described the role of advisory committees as helping the utility test its ideas in a frank and critical setting so that the utility can improve its decisions. NWE’s inability to participate productively in that process is worrisome, he said.

Dr. Power made clear that he does not believe that the entire corporation is dysfunctional. He said NWE has managed and maintained the transmission and distribution systems well. NorthWestern has also played a very productive role on a variety of other fronts: (1) it has invested in favorably-priced, wind generation that mitigates the price risk associated with future carbon regulation and has been engaged in efforts to understand and manage integrating wind

into the electric grid; (2) it has expanded its efficiency and demand side management programs (although Dr. Power said there is more cost effective DSM available to be pursued and it could be pursued on a more aggressive schedule); (3) it defended the USB program and all of its authorized public purposes while endeavoring to strike an appropriate funding balance among the various programs; and (4) it has supported, overall, low income programs during a period of rising market prices for energy focusing not only on low income discounts but also ongoing low income weatherization. Dr. Power said that in most areas NWE has served Montana customers well since it took over the MPC non-generating assets, but that does not mean no further changes are needed within NWE to protect the long-run interests of its Montana customers.

Dr. Power claimed that in the past NorthWestern demonstrated that it agreed with the Commission's guideline that "management of the utility is most effective when located where the company has the majority of its business." Dr. Power noted that from its founding in 1923 until 1997 the corporate headquarters of NorthWestern was located in Huron, South Dakota, not Sioux Falls. Huron is about 120 miles northwest of Sioux Falls and is located in the center of NorthWestern's South Dakota service territory. According to Dr. Power, prior to NorthWestern launching its ill-fated diversification-through-acquisition adventure, it recognized the importance of locating its corporate headquarters in Huron in the center of its service territory. He said, however, that in 1997 NorthWestern's leadership decided the company needed a more cosmopolitan corporate headquarters than Huron provided and decided to move the corporate offices to Sioux Falls, the fastest growing of South Dakota's metropolitan areas, but a city where NWE provides no utility service. In 1998 the company changed its name from NorthWestern Public Service Company to NorthWestern Corp. According to Dr. Power, the Sioux Falls corporate headquarters made sense only when NorthWestern was focused on becoming a non-utility business with holdings across the nation. Dr. Power said that, given the catastrophic failure of NorthWestern's diversification ventures, the reason for the Sioux Falls headquarters has been lost and is a remnant of a misguided business venture. Given that NorthWestern is once again primarily a regulated utility, Dr. Power argued its corporate offices ought to be located where the bulk of its utility activities are located.

Dr. Power contended that, in terms of relative importance of NWE's three separate service territories, Montana dominates South Dakota and Nebraska. Montana is the source of approximately 90 percent of NWE's before tax profits. Montana has close to 90 percent of

electric energy sales, 84 percent of electric customers, 75 percent of the employees, and two-thirds of natural gas customers and sales. Montana is now the business center of the NorthWestern Corporation, according to Dr. Power.

Dr. Power argued the geographic distribution of NorthWestern's corporate officers is completely out of balance with the geographic distribution of business activity, profit potential, risk, employees, and customers. He said there are 15 corporate officers, with 11 of them located in the Sioux Falls corporate headquarters. The Montana corporate officers include four vice-presidents (wholesale operations, retail operations, government and regulatory affairs, and administrative services). NWE has set up an Energy Supply Board that has five members on it. Two of those, Pat Corcoran and David Gates, work in Butte. The other three members of the Energy Supply Board are based in Sioux Falls.

Dr. Power recommended the Commission condition any approval of the BBI-NorthWestern merger on BBI's agreement to, within a relatively short period of time such as three years, move NorthWestern's corporate offices to Montana. He argued that NorthWestern, to thrive, needs to know Montana well: its customers, its regulators, its government officials, and other stakeholders. He said the company has to have its pulse on changing conditions, emerging trends, developing public opinion, and new opportunities and that it cannot do that from a distant corporate headquarters.

Dr. Power suggested a three-year period over which corporate leadership would relocate to Montana to avoid the disruption that would ensue from abruptly trying to change the geographic location of corporate headquarters.

Alternatively, Dr., Power said NorthWestern could be broken into two autonomous pieces: the South Dakota-Nebraska operations and the Montana operations. After all, according to Dr. Power, NorthWestern Public Service Company successfully served its South Dakota and Nebraska customers for almost 80 years before the Montana operations were added to the corporate mix. Dr. Power suggested the NorthWestern Public Service Company could be resurrected as an independent company owned by BBI and the Montana Power Company name could be resurrected in Montana for an independent company also owned by BBI.

Prefiled response testimony of Barbara Alexander (AARP)

Ms. Alexander stated that the purpose her testimony was to address the risks and potential impacts of this transaction on NWE's limited income or payment-troubled customers and to propose conditions that the Commission should adopt if the transaction is approved. The terms "limited income" and "payment troubled" are explained on page 3 of her testimony.

Ms. Alexander proposed that the Commission impose the following six conditions associated with any approval of this transaction:

- Implementation of a permanent increase in NWE's low income discounts and in the participation rate for the discount program. She recommended that the natural gas discount be increased to at least 30 percent for the winter period (November through April) and the electric discount be increased to 25 percent on a year-round basis. These increased discounts should be funded through current USB rates imposed on all customers, but if those rates are insufficient to maintain the program as participation in the discount increases, the increased funding should be provided by BBI as a merger benefit at least until NWE files its next rate case or three years, whichever is longer.
- Adoption by NWE of new eligibility guidelines for the low income discount program. The discount should be available to any customer who is participating in the Low Income Energy Assistance Program (LIEAP), as well as other means-tested state financial assistance programs that reflect the 150-180 percent of federal poverty level. These programs include Food Stamps, Medicaid, Temporary Assistance for Needy Families, Special Supplemental Assistance for Women, Infants and Children, Social Security Disability and other limited income drug prescription programs available in Montana, particularly for seniors. Customers who are already enrolled in these financial assistance programs should be automatically eligible for the NWE discount program. NWE should solicit these customers to enroll through coordinated mailings with other Montana assistance program administrators and allow these customers to orally self-declare eligibility and provide proof of program participation within a reasonable time period.
- An increase of NWE's contribution to the weatherization program in Montana. Any increase should reflect recommendations from the weatherization administrator and the

local delivery system for this program, based on their ability to absorb these additional funds and spend them efficiently in any program year.

- Require that NWE evaluate its USB-funded programs in sufficient detail to determine the effectiveness of these programs and identify potential areas of reform on a regular basis. Ms. Alexander said this will require, with respect to limited income programs, that the utility evaluate the impact of the program on the ability of participating customers to make regular monthly payments, enter into and keep payment agreements, avoid disconnection of service, and reduce the use of the utility's customer care and calling center expenses. She said NWE should be required to track and report routine credit and collection information for all its residential customers, as well as the subset of limited income customers participating in the discount programs. NWE should be required to report annually to the PSC on the operations of its gas and electric USB programs, as well as submit the required credit and collection information that would allow the Commission and the public to determine the status of NWE's limited and payment troubled customers.
- Require that NWE make its Home Heating Assistance Program more accessible to Montana customers. Ms. Alexander said the program should continue to be funded by NWE and BBI shareholders until NWE files its next rate case or three years, whichever is longer, as a merger benefit. The program should be made available to any NWE customer with a household income of 185 percent of poverty or less. NWE should conduct outreach efforts to encourage potentially eligible customers to apply for this program and not rely strictly on enrollment activities associated with LIEAP or Energy Share, although those enrollment methods should continue. Rather than targeting all the funds strictly as a heating benefit available to NWE's natural gas or electric heating customers, a lesser grant (in the amount of \$100-\$150) should be available to Montana electric customers who do not heat with electricity, but who encounter hardship in paying their NWE electric bill due to high heating costs for other fuels.
- Require that NWE's call center performance improve so that an average of 80 percent of the calls are answered by a representative within 30 seconds. Ms. Alexander said NWE should be required to achieve this level of performance within 6 months of the approval of the merger. If NWE does not achieve and maintain this level of performance on an

annual basis, BBI should fund a customer credit to NWE's Montana customers in the amount of \$1 million for each percentage below the 80 percent annual average performance that is achieved. According to information detailed in Ms. Alexander's testimony (see page 24), a review of various service performance indicators for 2004 and 2005 showed a high level of performance for most service metrics, except for the customer call center. Ms. Alexander said NWE's results for "calls answered within 30 seconds" in 2004 and 2005 were at 71.4 percent and 57.4 percent, respectively. She argued the degradation in call center performance from 2004 to 2005 is particularly disturbing.

Ms. Alexander said the NorthWestern/BBI application lacked specificity with respect to the impact of the merger on NWE's limited income or payment troubled residential customers. Ms. Alexander is concerned that customers will bear significant risks associated with the transfer of ownership to an Australian-based investment vehicle that is answerable to shareholders for a stock listed in Australia. She contended the lack of any specific and enforceable service commitments is disturbing because the urge to generate the return on the substantial investment that will be made to acquire NWE may result in pressure to cut costs and reduce expenses, thus adversely impacting customer service and service reliability and the ability of limited income and payment troubled customers to maintain utility service.

According to Ms. Alexander, customer service activities such as customer call center performance and timely and accurate billing are at risk when a utility with historically good service quality is subjected to pressures to assure adequate profits to absentee landlords. She said fixed-income, limited-income and payment troubled customers rely on access to customer call centers to negotiate payment arrangements, respond to disconnection notices, and enroll in various limited-income programs. The receipt of timely and accurate bills with a well understood and efficient collection routine is crucial to such customers' ability to manage their monthly payments and seek financial assistance which is typically triggered on the receipt of an accurate disconnection notice.

Ms. Alexander supported her testimony with overviews of NWE's USB programs for both electric and natural gas service, NWE's limited income and payment troubled customer

population, the low-income weatherization program, LIEAP, and NWE's Challenge Grant bill payment assistance program.

Other Intervenors

Heartland/SDPPI, the Large Customer Group, and CELP/YELP submitted statements in which they advised the Commission and other parties that they waived their rights to submit initial prefiled testimony but reserved all other rights of general intervention as well as the right to seek relief from PSC orders concerning issues raised by the PSC or any party.

APPLICANTS' REBUTTAL TESTIMONY

Prefiled rebuttal testimony of Michael Hanson (NorthWestern)

Mr. Hanson stated that none of the intervenors argued for disapproval of the sale, but rather each intervenor recommended conditions on the sale.

Mr. Hanson suggested that the Commission focus on what he said were certain key points of the application. He said NWE is a financially capable utility and that the best interests of the company, customers and regulators are served by ownership by a long-term investor like BBI that is focused on the utility business and its long-term financial health, rather than by the current ownership by short-term investors that are interested solely in maximizing their gains. He reiterated that, because NWE will remain the operating utility, the sale and merger transaction will be seamless to customers and cause no disruption in ongoing utility operations such as supply procurement. According to Mr. Hanson, BBI's ownership will mean NWE has access to capital for maintenance, growth, expansion and infrastructure projects at possibly lower costs than NWE could obtain as a stand-alone utility. He said investments in expansion projects requiring additional capital would require approval, as they now do, by a board of directors, and added that BBI has a direct interest in ensuring its operating companies get the necessary capital to maintain and expand their infrastructure.

According to Mr. Hanson, NWE is developing a long-term asset management plan, including expenditure forecasts, that initially will cover 10 years, but is planned to be extended to a 15-year horizon. He noted that all of BBI's operating companies have similar asset management plans.

Mr. Hanson responded to each of Dr. Wilson's recommended sale conditions as follows:

- Prohibition of recovery of acquisition premium in rates. Mr. Hanson responded that the applicants have unequivocally affirmed as much.
- Prohibition on transaction and transition costs recovered in rates. Mr. Hanson responded that the applicants have clearly stated they will not seek rate recovery of these costs.
- Current stipulation/settlement agreement and ring fencing. Mr. Hanson responded that: (1) the applicants have made clear they will abide by the terms of the agreement after the merger, and note the definition of "Parent" will need to be revised; (2) revision will be required to the agreement's requirement that every board member but one must be independent; and, (3) the ring-fencing provisions and Montana law will continue to provide the PSC with authority to regulate NWE, including rates, utility financing, debt and equity levels.
- Periodic rate informational filings. Mr. Hanson responded with a proposal that, instead of these filings being required every two years for the next ten years as recommended by Dr. Wilson, they be required to be filed every three years for the next six years.
- Filings of public financial disclosure documents with the PSC. According to Mr. Hanson, BBI will agree to notify the Commission when its public financial disclosure documents are being filed in Australia and provide links to the appropriate websites. NWE's financial disclosure documents will be available on the Securities & Exchange Commission's website.
- Project financing non-recourse to NorthWestern. Mr. Hanson responded that NWE, to the extent it undertakes capital projects that are not secured by conventional utility assets, will finance those projects by non-recourse project financing.

In response to Dr. Power's testimony, Mr. Hanson argued that the location of decision-making individuals is not important when day-to-day business communications are routinely accomplished by email, telephone, and video conferencing. He said these tools facilitate prompt and thorough decision making. Mr. Hanson noted that when decisions must be made that exceed the Montana-located executives' authority, they must seek approval from the CEO or board of

directors. Mr. Hanson acknowledged that NWE struggled to adapt to the role of default supplier, but added that even Dr. Power recognized NWE has made substantial progress by nearly completing its supply portfolio while continuing to provide reliable utility service. Mr. Hanson said Dr. Power's criticisms are not related to the proposed change in ownership which is the subject of this proceeding. According to Mr. Hanson, the proposed Montana Advisory Committee (discussed in Patrick Corcoran's rebuttal testimony) should result in improvements in NWE's decision-making processes.

Mr. Hanson disagreed with the recommendations for sale conditions made by intervenor witnesses Barbara Alexander and Ann Gravatt. He said NWE has demonstrated leadership and social responsibility regarding renewables, energy conservation and low-income issues, and is committed to continuing that leadership. For that reason, Mr. Hanson argued it is inappropriate and unnecessary to condition the sale as recommended by Ms. Alexander and Ms. Gravatt.

Prefiled rebuttal testimony of Patrick Corcoran (NorthWestern)

Mr. Corcoran said that, as part of NWE's efforts to improve its Montana focus and make NWE more responsive to Montana concerns, the company proposes to form a Montana Advisory Committee of external stakeholders representing major customer segments or utility interest groups. The new committee would be comprised of the members of the existing electric default supply Technical Advisory Committee (TAC), with the addition of representatives from AARP, Large Customers, Montana Chamber of Commerce and Montana League of Cities & Towns. Exhibit___(PRC-01) provides details concerning the proposed committee.

In response to Ms. Gravatt's testimony, Mr. Corcoran said NWE will continue to focus on renewable resources and energy conservation, but that those issues are appropriately discussed and considered in other forums and are not the subjects of this proceeding.

Mr. Corcoran responded to Ms. Alexander's testimony by first reiterating NWE's commitment to supporting the needs of its low-income customers. He stated that USB programs and funding are not at risk as a result of the proposed sale. Regarding the six sale conditions recommended by Ms. Alexander, Mr. Corcoran argued the first four conditions (increase low-income discount, expand discount eligibility, increase NWE's contribution to weatherization, and require NWE to evaluate and report on its USB-funded programs) are not appropriate subjects for this docket. He said her condition #5 (reform NWE's challenge grant) is

inappropriate because AARP's approach will actually discourage this type of program, which is a voluntary shareholder-funded activity begun at NWE's own initiative. Mr. Corcoran contended that Ms. Alexander's proposed sale condition #6 (require NWE to improve its call center answering performance to 80 percent of calls answered within 30 seconds, with a financial penalty to be funded by BBI if the performance metric is not met) is based on an anomalous high-level review of a single call center performance measure and seems to be an attempt to leverage the sale to secure the proposed penalty. Mr. Corcoran added that NWE's call center performance is one of the criteria considered by PA Consulting Group when determining which utilities' should be awarded its ServiceOne™ award, which NWE has been awarded for the past three years.

Prefiled rebuttal testimony of Steven Boulton (BBIL)

Mr. Boulton, the CEO of BBIL, rebutted MCC witness Dr. Wilson's testimony. According to Mr. Boulton, because the intervenors, including MCC, have indicated NWE is providing adequate service at reasonable rates, the only relevant issue in this proceeding is whether NorthWestern will be adversely affected by BBI's acquisition of it.

According to Mr. Boulton, NWE will operate in the same manner after the sale as it does now, except that its shareholder will be one long-term investor. He said BBI intends to keep NorthWestern in its present form, but as an operating company within a holding company. The rate base, its capitalization, and tariffed services will not be affected by BBI's acquisition of the company; in fact, they cannot change without the Commission's approval.

Mr. Boulton argued that NorthWestern's financial condition should improve after the merger. Nothing about the operation of the company will change, he said, except that with BBI ownership, NorthWestern will be able to invest in larger growth projects that provide the opportunity to earn an adequate rate of return.

Mr. Boulton pointed out that BBI has already committed to the Commission and to the other regulatory commissions involved that the acquisition premium and any transaction costs will not be recovered in rates, that public financial disclosure documents will be available to regulators, and that NorthWestern's or BBI's capital projects that are not secured by conventional utility assets will be financed by non-recourse project financing. BBI has also made clear that NWE will continue to be subject to the terms of the bankruptcy settlement

agreement with changes made to the agreement to revise: the definition of “Parent” to apply to NorthWestern; the board composition to recognize the new board as an internal board, not a public one; and the informational rate filing requirement to require such filings at least every three years over the next six years.

Mr. Boulton disputed Dr. Wilson’s recommendations resulting from his analysis of BBI’s acquisition model, which Mr. Boulton said was solely intended as an evaluation tool of the NorthWestern acquisition for BBI management. He contended the model was not designed to serve as an operating model or business plan for NorthWestern. Under BBIL ownership, he said, NorthWestern will develop its own business plan, consistent with BBIL’s strategy of empowering local management to run the business. Mr. Boulton criticized Dr. Wilson for focusing his analysis of the proposed acquisition exclusively on the BBI acquisition model and using it for a purpose for which it was not designed. Mr. Boulton asserted that a key assumption of NorthWestern and BBI is NorthWestern will use revenues to first pay all operating expenses, including interest and debt service, cash taxes, and prudent and necessary capital expenses, and retains sufficient working capital and cash to fund the day-to-day operating requirements, before any returns are made to the owner.

Mr. Boulton stated that, contrary to Dr. Wilson’s assertions, BBI has no intention to extract excessive cash distributions from NorthWestern. He argued that the Commission can ensure NWE’s financial viability by: (1) regulation of NWE’s rates, including establishment of the capital structure; (2) PSC approval of debt issuances secured by NWE’s utility assets in Montana; (3) PSC review of annual regulatory reports, NorthWestern’s SEC filings and reports, and the PSC’s ability to conduct investigations if concerns arise; and, (4) monitoring NWE’s continued implementation of the Liberty Audit recommendations and, possibly, the proposed NWE 10-year asset management plan.

Regarding Dr. Wilson’s specific recommendations, Mr. Boulton responded as follows:

- Prohibition of recovery of acquisition premium in rates. Mr. Boulton responded that NorthWestern and BBIL, in the answer to MCC Data Request MCC-13(b), clearly indicated they do not intend to recover the premium to book in rates. He added that NWE would not be able to do so anyway unless it first obtained PSC approval to include it in rate base or treat it as an amortization expense.

- Prohibition on transaction and transition costs recovered in rates. Mr. Boulton responded that NorthWestern and BBIL, in the answer to MCC Data Request MCC-063, clearly indicated these costs are being expensed as they occur and tracked in the company's financial statements, and will not be included in future rate filings. He added that NWE would not be able to recover these costs in rates anyway unless it first obtained PSC approval in a rate filing.
- Project financing non-recourse to NorthWestern. Mr. Boulton responded that NorthWestern and BBIL clearly indicated in the application that they will not issue Montana utility debt, pledge Montana utility assets, or provide loans, guarantees, etc. related to Montana regulated utility assets, except in accordance with Montana law and PSC rules. He noted that the Commission regulates the issuances of securities, including pledges of utility property. He said that, although the acquisition model's assumptions may include some related to future debt issuance as the company grows, any issuance other than non-recourse borrowings is a modeling exercise without effect unless and until the PSC authorizes such debt.
- Current stipulation/settlement agreement and ring fencing, and recommendations for revisions to Ordering ¶ C.3 of the agreement. Mr. Boulton responded the applicants have made clear they will abide by the terms of the agreement after the merger, and noted the definition of "Parent" will need to be revised and revision will be needed to the agreement's requirement that every board member but one must be independent. He argued there is no need to revise Ordering ¶¶ C.3.b & c as recommended by Dr. Wilson because those provisions will remain in place and unchanged. He disputed the need to change Order ¶ C.3.a because the existing definition of consolidated book equity and consolidated total capitalization is consistent with Generally Accepted Accounting Principles while Dr. Wilson's concerns are unwarranted and inconsistent with industry practice.
- Periodic rate informational filings. Mr. Boulton responded with a proposal that, instead of these filings being required every two years for the next ten years as recommended by Dr. Wilson, they be required to be filed triennially once or twice.
- Filings of public financial disclosure documents with the PSC. According to Mr. Boulton, BBI will agree to notify the Commission when its public financial

disclosure documents are being filed in Australia and provide links to the appropriate websites.

- Prohibition on payment of dividends above 100 percent of net income in any year without prior PSC approval. Mr. Boulton argued this condition is inappropriate for these reasons: (1) it appears to apply to all of NorthWestern when the Montana PSC has no jurisdiction over NWE's regulated operations in other states or over NorthWestern's unregulated operations; (2) it usurps the legal authority of NorthWestern's board of directors and could conflict with the board's fiduciary responsibilities and with laws governing dividend payments; (3) it is unnecessary, given the PSC's authority over rates, debt issuance, ability to investigate and audit, and the required rate informational filings; (4) it ignores the fact that consolidated income taxes may be paid by the holding company and not NWE as the operating company, necessitating distributions from NorthWestern to Holdco as the taxpayer for the consolidated group; (5) it fails to take into account that, just because a company may choose to pay more in dividends than its book net income in a year does not mean it is impaired from providing adequate service; and, (6) NWE's proposed long-term asset management plan will demonstrate NorthWestern's commitment to infrastructure investment.

Mr. Boulton contended that Dr. Wilson's analysis of BBI's financial projections contains material flaws that are the result of his misapplication of the acquisition model and from what appears to be his selective use of data to justify erroneous conclusions. In conclusion, Mr. Boulton stated that the information provided in the application, direct and rebuttal testimony, and discovery responses all add up to a convincing demonstration of BBIL's suitability as a purchaser of NorthWestern.

Prefiled rebuttal testimony of Jonathon Sellar (BBIL)

Mr. Sellar, BBIL's chief financial officer, rebutted Dr. Wilson's testimony, particularly the conclusions drawn by Dr. Wilson from his analysis of BBI's acquisition model. According to Mr. Sellar, Dr. Wilson inappropriately applied the acquisition model to the public utility ratemaking process and then claimed it showed how the post-merger NorthWestern will operate.

Mr. Sellar stated that the purpose of the model was to evaluate the effect of the transaction on the BBI stockholder; therefore, BBI included the premium to book in the model so that it would accurately reflect BBI's economic investment. He reiterated that BBI has no intention of recovering the acquisition premium in rates.

According to Mr. Sellar, Dr. Wilson's claim that NorthWestern will increase its equity payouts for the period 2007-2010 to \$660 million from the \$203 million projected by NorthWestern in its 2006 Long Range Forecast is not correct. Mr. Sellar contended that the net distributions assumed by BBI and NorthWestern during this period are about equal because the model shows not only \$660 million in distributions, but \$405 million in reinvestment of equity capital by BBI, which results in a net distribution of \$255 million.

Mr. Sellar responded to Dr. Wilson's four major concerns, which, according to Mr. Sellar, are all related to a misuse of the model:

- NorthWestern intends to retain for ratemaking the premium to book offered by BBI. Mr. Sellar responded that this concern is misplaced because the Commission determines regulated rate base and the equity and debt components of it. He said that NWE's current regulated capital structure is about 50/50 debt to equity and that, while the equity component will increase as total rate base increases, the debt component can only increase if the PSC authorizes it. He asserted that for Montana ratemaking purposes, the equity component of rate base will likely increase over time, not decrease.
- NorthWestern intends to invest annually less than its annual depreciation expense. Mr. Sellar responded that Dr. Wilson's comparison of forecast capital expenditure to a GAAP depreciation charge is not relevant or reasonable. He said that if Dr. Wilson's analysis of capital expenditure as a percentage of GAAP depreciation were extended over the entire 40-year life of the BBI model rather than to just the first 15 years used by Dr. Wilson, then capital expenditures exceed GAAP depreciation expense. He argued that Dr. Wilson's analysis was faulty because he included in depreciation expense the Colstrip 4 lease buyout cost, but did not include that capital cost when he calculated capital expenditures -- a difference that makes up more than half of Dr. Wilson's "shortfall," according to Mr. Sellar. Further adjustments for remaining GAAP depreciable life of the assets, and inclusion of all depreciation and capital expenditures

through the end of 2023, result in a capital expenditure amount well in excess of book depreciation (by \$258 million), argued Mr. Sellar.

- BBI projects a 25-30 percent return on its investment by 2023. Mr. Sellar claimed that BBI's total internal rate of return in regard to the overall consolidated NorthWestern transaction over the 40-year evaluation term is 11.9 percent. With respect to regulated Montana gas and electric rate base return on investment, Mr. Sellar contended the BBI model projects a return on the electric business of 7.5 percent and a return on the gas business of 7.7 percent over the 17-year evaluation period referenced by Dr. Wilson. Regarding Dr. Wilson's calculation of a rate of return on equity-funded rate base (RREFRB), Mr. Sellar argued that Dr. Wilson's use of consolidated numbers distorts the results. Mr. Sellar said that when he used Dr. Wilson's methodology to calculate RREFRB metric for each of the Montana utilities, the resulting ratios through 2023 for the Montana electric assets was 7.5 percent and 7.7 percent for the gas assets.
- BBI proposes to recover "phantom taxes" from ratepayers. Mr. Sellar responded that the availability of NOLs carry forward to NorthWestern is irrelevant to this proceeding. He explained the NOLs were generated by the write-off of some of NorthWestern's unregulated businesses and the investments that resulted in the NOLs were never included in rate base and are not related to NWE's regulated Montana utility. He said the use of the NOLs will result in higher available cash flow during this period after all other needs are met.

Mr. Sellar disputed Dr. Wilson's conclusion that, as a result of the two new transmission projects planned by NWE and supported by BBIL, NorthWestern debt will increase from \$736 million in 2006 to \$1.854 billion at the end of 2009, while equity will decline from \$732 million to \$531 million. According to Mr. Sellar, the financing of the larger of two transmission projects, as well as the cost of the Colstrip 4 lease buyout if that occurs, will be fully non-recourse to NWE and not included in rate base. He added that Dr. Wilson should have pointed out that in 2010, BBIL's plans call for a \$400 million injection of equity capital into these projects to repay short-term, non-recourse construction debt and achieve a 50/50 debt/equity capitalization for the largest of the projects and an approximately 50/50 debt/equity capitalization on a consolidated NorthWestern basis.

According to Mr. Sellar, Dr. Wilson's contention that BBIL plans excessive equity distributions that are outside of industry norms is incorrect. Mr. Sellar said that if the BBIL projections are adjusted to make them actually comparable to other utilities and if Dr. Wilson's list of comparable utilities is revised and expanded to include utilities similar to NorthWestern with primarily regulated assets, BBIL's projections are consistent with the historical distributions of that utility group. (See pages 12-13 of Mr. Sellar's rebuttal testimony and his Exhibit___(JS-1).)

Mr. Sellar argued that Dr. Wilson's concern that BBI Holdco financial statements indicate an ongoing balance of less than 3 days of revenues is another result of his misapplication of the BBI acquisition model, which was not designed to model NorthWestern's working capital management. Mr. Sellar said that, post-merger, BBIL expects NorthWestern to continue to manage its working capital as it does today and that only excess cash not needed to manage its liquidity would be distributed up to BBI on a quarterly basis.

Mr. Sellar concluded by reiterating that BBI has no intention of extracting excessive distributions from NorthWestern, but rather BBI intends to be a long-term investor with an interest in ensuring NorthWestern remains a financially strong, customer-focused utility.